International Insights: Major Pension Reform Considerations

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Acknowledgement - Presentation draws on OECD Research and Presentations - ‘Pensions at a Glance’ – Edward Whitehouse
Pension Reform – Period of Uncertainty

- Financial
- Economic
- Pension Reform Impact
Employer and Employee Challenges

• Sharp increase in DB to DC transition
• ‘Democratization of Risk’ for the plan or scheme members
• Breakdown of paternalistic employer tendencies
  – Economic survival
• Who pays for the transition and employee benefits in the future
• Role of government – political risk
• Default fund structures
• Member engagement – can we make plan members CIOs
Psychological Barriers & Behavioural Economics

A relatively new branch of economics that incorporates psychology

It accepts that consumers are irrational in their decision making: they do not always make choices that are in their own best interest

Psychological barriers to good decision making affect everyone – even sophisticated investors...

Example: In the late 1990s a client’s scheme had a high proportion of members investing in the Japanese Smaller Companies Fund which was performing very badly. The client found that its own Japanese Equity Desk was leading colleagues into the fund on the basis that they were investing in what they knew. These were sophisticated investors making irrational choices about their own pensions.
It started as a financial crisis.

This had a direct effect on people’s private pensions and other retirement savings.
But it became an economic crisis.

Higher unemployment and pressure on wages cuts revenues from taxes and contributions.
OECD average: 7.2%
No country, no pension system is immune from the effects of the crisis

Impact is greatest...

- where pensions and other savings are significant
- on workers near retirement
- where people’s retirement savings are invested in riskier assets
- where public pension spending was already high
- where old-age safety-nets and automatic stabilisers are weak
- Questions on default, investments and member-engagement
Gross pension replacement rate for average earner (%)
Contribution of private savings to total retirement income
Selected countries, latest available year, %

- Canada
- Netherlands
- United States
- Australia
- Britain
- Denmark
- Ireland
- Sweden
- Germany
- Iceland
- Japan
- France
- Belgium
- Spain
- Italy
- Austria
- Poland
- Czech Republic

Source: OECD
Policy responses

What are countries doing?

What are the options and the arguments?

- Stronger safety-nets for old-age incomes
- One-off payments as part of stimulus packages
- Early access to some retirement savings
- Encourage workers to move to less risky assets as retirement nears
Further challenges:

Avoid resorting to early retirement or disability benefits to keep unemployment figures lower.

Long-term problems, such as ageing, have not gone away.
Expected retirement duration, OECD average (years)

- Men
- Women
Policy issues for the UK

- Will personal accounts increase coverage?
- Recycling and re-using existing pensions infrastructure
- Delivering personal accounts
- Administration capability
- Previous private pension failures
- Pension mis-selling and the related challenges
- Public-sector pensions: time for more reform?
Policy issues for NZ

- Low voluntary pension coverage before Kiwisaver -17% coverage
- Automatic enrolment predicated on behavioural finance
- Opt out of the system – Day 16 -54 of starting new employment
- Employer, Employee and Government contributions
- Government co -contribution rejected by new National led government
- New Zealand highly generous first pillar PAYG pensions model
Policy issues for Germany

- Generous first pillar PAYG social security system
- Benefit calculations will see 1st pillar pensions cut for younger worker
- Employer sponsored schemes moving towards full funding from book reserves
- Riester reforms – personal pensions savings continues to be strong
- Strong capital guaranteed products
- Further pension reforms are being evaluated – after national elections
Coverage of private pensions (%)

Age group

- Canada
- Germany
- Ireland
- United States
Key Observations

• Global pension reforms will need to increase in tempo
• Financial and economic considerations are shaping pension reforms
• Tax incentives, soft-compulsion (auto-enrolment) and mandation are being considered by national governments
• Demographics are driving the pace of pension reform
• Default and investment structures will closely mirror plan member behaviours

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